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Supreme Court of the United States

OCTOBER TERM, 1945.

Nos. 848, 849. 42-43

In the Matter
of
AMERICAN FUEL & POWER COMPANY,
INLAND GAS CORPORATION,
KENTUCKY FUEL GAS CORPORATION,
Debtors.

VANSTON BONDHOLDERS PROTECTIVE COMMITTEE,
Petitioner,

—against—

LOUIS A. GREEN and ROBERT HEILBRUNN, Known in these Proceedings as the Green Committee and MORRIS GREEN,
Respondents.

VANSTON BONDHOLDERS PROTECTIVE COMMITTEE,
Petitioner,

—against—

CARL B. EARLY, DANIEL MATTHEWS, THOMAS MATTHEWS, JACK PATTON and P. G. MEADOR,
Respondents.

BRIEF OF GREEN COMMITTEE AND MORRIS GREEN IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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BRIEF OF GREEN COMMITTEE AND MORRIS GREEN IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

Statement.

Petitioner is a committee of first mortgage bondholders of Inland Gas Corporation, debtor in reorganization. The deed of trust, securing the first mortgage bonds, was executed in the State of New York. The bonds and the interest coupons thereto attached were also executed and issued in that state;

and were payable there, at the office of the indenture trustee, or at the option of the bearer, in Illinois. There is no evidence of record that any bondholder demanded payment in Illinois. Nor do the proofs of claim filed by the bondholders indicate that any coupons have been detached from the bonds or negotiated to third parties (Opinion, Circuit Court of Appeals, R. 381, 2; 151 F. (2d) p. 475).

Petitioner seeks to enforce a clause in the deed of trust providing for interest on interest, the construction and validity of which provision under New York law is the matter in dispute between petitioner and other creditors of the corporation. No controlling federal statute on the subject is involved.

Decisions Below.

The District Court, without rendering an opinion, decided that a promise to pay interest on interest is valid under New York law (R. 148).

The Circuit Court of Appeals reversed this decision in an opinion reported 151 F. (2d) 470 (1945), holding such a promise to be invalid under New York law.

Questions Presented.

The questions presented as stated by petitioner are as follows:

1. Whether in determining the rule for the choice of the governing local law concerning the validity of an interest provision in a multi-State contract made by a Debtor in Chapter X Proceedings the bankruptcy court should select the choice of law rule of the forum State.

2. Whether such interest provision is invalid, although it does not violate the public policy of any of the States involved, nor of the United States, and would have been upheld if it had been litigated in the Courts of any of such States.

We do not agree with this statement of the questions involved. The real questions are as follows:

1. Whether an issue of federal choice of law is presented where first mortgage bondholders of a corporation in reorganization proceedings seek to enforce a clause in a deed of trust indenture providing for interest on interest, the construction and validity of which provision under New York law is the matter in dispute between petitioner and other creditors of the corporation, and no controlling federal statute is involved?

2. Whether the considered determination of questions of state law by the Circuit Court of Appeals, predicated upon decisions of the highest court of the state, is ordinarily reviewed by this Court?

ARGUMENT.

I.

No issue of federal choice of law is presented.

The petition for certiorari suggests that there is an issue in this case as to "whether state law or federal law determines the choice of law in bankruptcy."

It is repectfully submitted that no such question is presented by the record in this case, and that the only question involved pertains to state law. The con-

troversy arose solely from the efforts of certain first mortgage bondholders of a corporation in reorganization proceedings to enforce a clause in a deed of trust indenture providing for interest on interest, the construction and validity of which provision under New York law became a matter in dispute between petitioner and the respondents, as creditors of the corporation. No controlling federal statute on the subject is involved.

The petitioner apparently fails to recognize the clear distinction between such a situation and one requiring the interpretation and application of a federal statute. Thus, the petitioner inappositely cites *Wragg* v. *Federal Land Bank*, 317 U. S. 325, where this Court held that in the interpretation and application of the Bankruptcy Act as in the case of other federal statutes, federal not local law, applies; *Sola Electric Co.* v. *Jefferson Electric Co.*, 317 U. S. 173, in which it was declared to be familiar doctrine that the prohibition of a federal statute may not be set at naught, or its benefits denied, by state statutes or state common law rules; *D'Oench* v. *Federal Deposit Insurance Corporation*, 315 U. S. 447, where the respondent, a federal corporation, brought suit under an Act of Congress providing that "All suits of a civil nature at common law or in equity to which the Corporation shall be a party shall be deemed to arise under the laws of the United States"; *McKenzie* v. *Irving Trust Co.*, 323 U. S. 365, holding that "What constitutes a transfer and when it is complete within the meaning of §60a of the Bankruptcy Act is necessarily a federal question, since it arises under a federal statute intended to have uniform application throughout the United States. *Prudence Corp.* v. *Geist*, 316

U. S. 89, 95, and cases cited; *Steele* v. *Louisville & Nashville R. Co.*, 323 U. S. 192, 204. The statute provides its own definitions. * * * In the absence of any controlling federal statute, a creditor or bona fide purchaser could acquire rights in the property transferred by the debtor, only by virtue of a state law."

Hence, if the Circuit Court of Appeals here had applied a New York rule of law governing insolvency proceedings, or if this case raised questions concerning the equitable power of a federal bankruptcy court to subordinate claims of some creditors to those of others, the petitioner would have an arguable point, since the Bankruptcy Act provides its own criteria for distribution to creditors. (*Prudence Corp.* v. *Geist, supra,* and to the same effect, *American Surety Co.* v. *Sampsell,* decided February, 1946, by this Court.) But there is no issue of state insolvency rules or of federal equitable subordination principles here, for all that the Circuit Court of Appeals in this case had before it for determination, and actually decided, was the construction and validity of a covenant providing for interest on interest, a subject upon which the Bankruptcy Act does not provide its own criteria. Controversies of this sort arising in bankruptcy cases were solved by reference to state law even before the decision of *Erie R. Co.* v. *Tompkins, infra* (*Corn Exchange Bank* v. *Klauder;* 318 U. S. 434).

In *Klaxon Co.* v. *Stentor Co.,* 313 U. S. 487, it was expressly held that the prohibition declared in *Erie R. Co.* v. *Tompkins,* 304 U. S. 64, against independent determinations by the federal courts, extends to the field of conflict of laws. We submit that this Court

in *D'Oench* v. *Federal Deposit Insurance Corporation, supra,* cast no doubt upon the application of the *Klaxon* rule to cases where, as here, no federal statute is involved.

Moreover, it is the local factor which produces the variability of result in the various Circuit Courts of Appeal, and the petitioner, in failing to take this into account, arrives at the erroneous conclusion that there is a conflict.

> "As to questions controlled by state law, however, conflict among circuits is not of itself a reason for granting a writ of certiorari. The conflict may be merely corollary to a permissible difference of opinion in the state courts."
>
> *Ruhlin* v. *New York Life Insurance Co.,* 304 U. S. 202, 206 (1938).

As to *Seeman* v. *Philadelphia Warehouse Company,* 274 U. S. 403 (1927), relied upon by the petitioner, we need only refer to the *Corn Exchange Bank* case, *supra,* where the decision in *Salem Trust Co.* v. *Manufacturers Finance Co.,* 264 U. S. 182, of a similar question as a matter of "general law" was held to be inapplicable since the decision of the *Tompkins* case, *supra.*

Whether the bankruptcy court in passing upon the construction and validity of the contract provision in question was sitting as a court of law or as a court of equity, the state court decisions were controlling (*Ruhlin* v. *New York Life Insurance Co., supra*).

It follows from the foregoing that the instant case presents no issue of federal choice of law.

II.

Considered determination of state law by the Circuit Court of Appeals, predicated upon decisions of the highest court of the state, is not ordinarily reviewed by this Court.

The deed of trust, securing the first mortgage bonds, was executed in the State of New York. The bonds and the interest coupons thereto attached were also executed and issued in that state; and were payable there, at the office of the indenture trustee, or, at the option of the bearer, in Illinois. There is no evidence of record that any bondholder demanded payment in Illinois. Nor do the proofs of claim filed by the bondholders indicate that any coupons have been detached from the bonds or negotiated to third parties (*Opinion, Circuit Court of Appeals*, R. 381, 2; 151 F. (2d), p. 475).

At this point we desire to draw attention to the fact that the petitioner erroneously states in a footnote to page 14 of its petition that "during all the period when these coupons became due the Company was either in Federal Equity Receivership or in 77-B or Chapter X proceedings," with references to pages 303 and 173 of the Record. The record references, however, do not support the petitioner's statement. At page 303 of the Record (the first reference), it appears that the initial appointment of a Receiver for the Company was on December 2, 1930. At page 173 of the Record (the second reference), we find a balance sheet of the Company as of December 2, 1930, the inception date of the receivership. Under "Accrued Interest on Funded Debt" appears the item "Payable February 1, 1931 on First Mortgage 6½% Bonds,

due February 1, 1938 . . . $93,655.37." As the bonds were issued February 1, 1928, it is obvious that the following coupons were paid prior to any receivership, 77-B or Chapter X proceedings: Coupon #1, due August 1, 1928; Coupon #2, due February 1, 1929; Coupon #3, due August 1, 1929; Coupon #4, due February 1, 1930; Coupon #5, due August 1, 1930.

Since, as stated by the Circuit Court of Appeals, the option of the bearer to demand payment in Illinois was never exercised, the primary place of payment was New York (Restatement, Conflict of Laws, §356). Hence, New York was not only the place of contracting but also the primary place of performance of the contract in question.

The Court of Appeals of Kentucky (the forum state) has declared that "it may be stated without exception that if under the *lex loci contractus* the contract for any reason is void, it will be invalid everywhere, and will not be enforced by the *lex fori,* although it would be valid if executed in that jurisdiction" (*Moody* v. *Barker,* 188 Ky. 401, 403).

In New York, the leading case on the subject of applicable choice of law is *Holley* v. *Talcott,* 129 App. Div. 233 (1st Dept., 1908), where it was held that the interpretation and validity of a contract for the loan of money is to be determined by the law of the place where the contract was made. The Court decided, therefore, that since the agreement to loan money took place in New York, the contract was a New York contract though the notes evidencing the transaction were signed and made payable in Pennsylvania, and the question as to whether it was usurious must be determined by the law of New York, not by that of Pennsylvania.

Nothing to the contrary was held in *Westchester Mortgage Co.* v. *Grand Rapids and Ionia Railroad Co.*, 246 N. Y. 194, cited by the petitioner, for it is clearly distinguishable on its facts. As was there stated (per Lehman, *J.*):

> "Unquestionably the note is usurious if it was made in the State of New York, and is governed by the laws of this State. The Appellate Division has made findings and conclusions to the effect that the note was made and delivered in Rhode Island, and its validity must be determined by the laws of that State" (p. 197).

Distinguishable, too, as involving a contract made elsewhere than in the State of New York, is the case of *Curtis* v. *Leavitt*, 15 N. Y. 9, upon which the petitioner relies. At page 227 of the opinion there we find the following:

> "The documentary and oral evidence shows that the contract for the sale of these bonds was made and the money advanced on them paid in England; that the semi-annual interest to accrue thereon was to be paid in London, and the principal ultimately to be repaid there. * * * These facts make the contract an English contract; and the question of usury, therefore, is to be determined by the English law."

The Circuit Court of Appeals in the instant case correctly ascertained the law of New York to be that a covenant made prior to the accrual of interest, to pay interest on interest, is contrary to the public policy of the state and is, therefore, unenforceable.

State of Connecticut v. *Jackson*, 1 Johns. Ch. 13;

Van Benschooten v. *Lawson*, 6 Johns Ch. 313;
Mowry v. *Bishop*, 5 Paige's Ch. 98;
Toll v. *Hiller*, 11 Paige's Ch. 228;
Forman v. *Forman*, 17 Howard's Practice Rep. 255;
Stewart v. *Petree*, 55 N. Y. 621;
Young v. *Hill*, 67 N. Y. 162;
Bailey v. *Buchanan County*, 115 N. Y. 297;
Williamsburgh Savings Bank v. *Town of Solon*, 136 N. Y. 465;
Columbus, S. & H. R. Co. Appeals, 109 Fed. 177 (C. C. A. 6);
In re Wisconsin Central Railway Company, 63 F. Supp. 151 (D. C., D. Minn. 1945).

Similarly relied upon by the Circuit Court of Appeals were two opinions of Mr. Justice Cardozo, writing for the Court, in *Continental Securities Co.* v. *N. Y. C. & H. R. Co.*, 217 N. Y. 119, 125:

> "It makes no difference that the promise to pay interest is represented by coupons. Until detached and separately negotiated, a coupon is merely an incident of the bond without greater force than any other promise for the payment of interest (*Williamsburgh Savings Bank* v. *Town of Solon*, 136 N. Y. 465, 481)."

And in *Newburger-Morris Co.* v. *Talcott*, 219 N. Y. 505, 510:

> "The charge of compound interest was correctly disallowed. The rule is settled that a promise to pay interest upon interest is void if made at a time before simple interest has accrued (*Young* v. *Hill*, 67 N. Y. 162). The provision in the contract that interest shall be 'charged on the account current * * * at the rate of 6 per cent per

annum,' must, therefore, mean simple interest. Any other promise, made at the outset of the dealings would be invalid."

As was stated by this Court in *Huddleston* v. *Dwyer*, 322 U. S. 232, 237:

> "The decision of the highest court of a state on matters of state law are in general conclusive upon us, and ordinarily we accept and therefore do not review, save in exceptional cases, the considered determination of questions of state law by the intermediate federal appellate courts, cf. *Ruhlin* v. *New York Life Ins. Co., supra.*"

CONCLUSION.

The petition for certiorari should be denied.

Respectfully submitted,

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